

# Notice To Members

National Association of Securities Dealers, Inc.

December 1988

## Number 88 - 97

### Suggested Routing:\*

- |   |  |  |                                    |
|---|--|--|------------------------------------|
| <input checked="" type="checkbox"/> Senior Management | <input type="checkbox"/> Internal Audit                | <input checked="" type="checkbox"/> Operations   | <input type="checkbox"/> Syndicate |
| <input type="checkbox"/> Corporate Finance            | <input checked="" type="checkbox"/> Legal & Compliance | <input type="checkbox"/> Options                 | <input type="checkbox"/> Systems   |
| <input type="checkbox"/> Government Securities        | <input type="checkbox"/> Municipal                     | <input checked="" type="checkbox"/> Registration | <input type="checkbox"/> Trading   |
| <input type="checkbox"/> Institutional                | <input type="checkbox"/> Mutual Fund                   | <input type="checkbox"/> Research                | <input type="checkbox"/> Training  |

\*These are suggested departments only. Others may be appropriate for your firm.

## Subject: Implementation of the Form U-4 Disclosure Reporting Page (DRP) Effective Immediately

### EXECUTIVE SUMMARY

A new Form U-4 attachment page, the Disclosure Reporting Page (DRP), has been developed for use by member firms to report the details of their registered representatives' disciplinary history. Effective immediately, all information provided to the Central Registration Depository (CRD) relating to Item 22 on Page 3 of Form U-4 should be submitted on a fully completed DRP.

Use of the DRP is expected to streamline the reporting, capture, and dissemination of disciplinary information.

### BACKGROUND

In July 1987 the NASD and the North American Securities Administrators Association (NASAA) met to address state concerns regarding the lengthy and often complicated summaries of disciplinary information contained in the CRD data base. The disclosure of disciplinary information by associated persons through Form U-4 historically has been received in a relatively unstructured format, with submissions to CRD

ranging from short, free-form summaries to hundreds of pages of documents. The NASD and NASAA sought to streamline and expedite the process of reporting and disseminating disciplinary information through the system. It was agreed that a uniform format for disclosure, which would provide more direction to the person completing the Form U-4, should be created. That format has now been developed and is incorporated into a revised attachment page to Form U-4 called the Disclosure Reporting Page (DRP).

The DRP is designed to simplify the submission of details to disciplinary questions on Form U-4 by soliciting only the pertinent facts relating to the disclosable matter. Since the DRP requires concise answers to these questions, the amount of data captured by CRD will be reduced, and disciplinary records will become more succinct and easier to understand. In addition, completion of each of these questions will significantly reduce the amount of paperwork now submitted by member firms.

### FILING REQUIREMENTS

The DRP contains nine (9) questions. The first eight (8) questions request specific facts relating to the incident being disclosed and must be answered. The last question provides space for the individual to include an explanation of the

optional, and the explanation must fit within the space provided.

A separate DRP must be submitted for each different event or proceeding that is being disclosed. Since an event or proceeding may relate to more than one question under Item 22, only one DRP need be provided, but it must reference all applicable "yes" answers on Page 3. A sample of a properly completed DRP, which provides the details of a settled customer complaint disclosed through Items 22H(1) and 22H(2) of Form U-4, is included. Please note that if the agent used in this example had been the subject of additional customer complaints that required disclosure, completion of a separate DRP would be necessary for each complaint.

Documents no longer are required to be submitted but may be attached to the DRP at the option of the member. If filed, the individual's record will indicate that they have been received, but no information will be captured from the documents. All pertinent details must be contained in the answers to the DRP questions. Jurisdictions that need copies of the documents will continue to request them from the CRD. While it is anticipated that full completion of the DRP will provide sufficient information in most cases, there may be situations where additional details are needed for a jurisdiction to complete its regulatory review. If that situation occurs, the jurisdiction will continue

to notify the firm directly to request the specific information required.

Effective immediately, all future disclosures relating to Item 22 of Form U-4 should be made on the DRP. The DRP should be used for all initial, transfer, and amended disciplinary filings. In order to allow members to become familiar with this new form, and to allow for submission of information that may have already been prepared under the existing format, the CRD will accept both the DRP and existing format until February 1, 1989. Following that date, all information must be provided on the DRP.

The Form U-4 instructions relating to Item 22 have been revised to require the filing of the DRP for all "yes" answers, and the existing attachment page has been revised to limit its use to the continuation of Form U-4 Items 18, 19, and 20. Firms may continue to use the existing attachment page provided they limit its use to Items 18, 19, and 20 of Form U-4. Copies of the DRP and the revised attachment page are included with this Notice for your firm's use. Please feel free to make copies of these forms.

Questions concerning this notice may be directed to Ellen J. Badler, Assistant Director, Special Registration Review at (301) 590-6743. For copies of the DRP and/or Form U-4, please call NASD Information Services at (301) 590-6500.

**FORM U-4**  
**UNIFORM APPLICATION FOR SECURITIES INDUSTRY REGISTRATION OR TRANSFER**  
**DISCLOSURE REPORTING PAGE (DRP)**

LAST NAME <b>DOE</b>	JR./SR., etc.	FIRST NAME <b>JOHN</b>	MIDDLE NAME (Specify if none) <b>ROBERT</b>
CRD # <b>8888888</b>	NFA #	SOCIAL SECURITY # <b>000-00-0000</b>	FIRM CRD # <b>88888</b>

**INSTRUCTIONS**

*This Disclosure Reporting Page (DRP) is to be used to report details of affirmative responses to Item 22 questions.*

- Use a separate DRP for each event or proceeding. Complete Items 1-8 below. (Item 9 is optional.)
- One event may result in more than one yes answer in Item 22; if so, use only one DRP to report this information.
- The information provided on this DRP will be entered into the CRD system verbatim. It is very important that clear and concise information be provided for each item on this form.
- It is not a requirement that documents be provided for each event or proceeding. Should they be provided with the DRP, they will not be accepted as disclosure in lieu of answering the questions on this form.

1. This DRP relates to the following questions in Item 22:

- |                                  |                                  |                                  |                                  |                                  |   |                              |                                  |
|----------------------------------|----------------------------------|----------------------------------|----------------------------------|----------------------------------|---|------------------------------|----------------------------------|
| <input type="checkbox"/> 22A (1) | <input type="checkbox"/> 22C (1) | <input type="checkbox"/> 22D (3) | <input type="checkbox"/> 22E (3) | <input type="checkbox"/> 22F (1) | <input type="checkbox"/> 22G                | <input type="checkbox"/> 22J | <input type="checkbox"/> 22N (1) |
| <input type="checkbox"/> 22A (2) | <input type="checkbox"/> 22C (2) | <input type="checkbox"/> 22D (4) | <input type="checkbox"/> 22E (4) | <input type="checkbox"/> 22F (2) | <input checked="" type="checkbox"/> 22H (1) | <input type="checkbox"/> 22K | <input type="checkbox"/> 22N (2) |
| <input type="checkbox"/> 22A (3) | <input type="checkbox"/> 22D (1) | <input type="checkbox"/> 22E (1) | <input type="checkbox"/> 22E (5) | <input type="checkbox"/> 22F (3) | <input checked="" type="checkbox"/> 22H (2) | <input type="checkbox"/> 22L | <input type="checkbox"/> 22N (3) |
| <input type="checkbox"/> 22B     | <input type="checkbox"/> 22D (2) | <input type="checkbox"/> 22E (2) | <input type="checkbox"/> 22E (6) | <input type="checkbox"/> 22F (4) | <input type="checkbox"/> 22I                | <input type="checkbox"/> 22M |                                  |

2. Is this DRP being filed to change or update any information regarding a previously reported event or proceeding?  YES  NO  
 Complete Items 1-8, and if yes, also circle the items below which are being changed.

3. Who initiated this event or proceeding? (Enter name of firm, regulator, court, customer, etc.)  
Mary Smith

4. What type of event or proceeding was this? (i.e. Customer Complaint, Termination, Civil, Administrative, Criminal, Arbitration)  
Customer Complaint

5. On what date was the event or proceeding initiated? April 1, 1988

6. Identify the docket or case number of the event or proceeding (if any). N/A

7. What were the allegations against you? (Include amounts of actual or alleged damages or claims.) Smith alleged she did not authorize the sale of shares of ABC Company which I sold for her on April 1, 1988. She also claimed she lost \$10,000 as a result of the sale.

8. a. What is the current status of the event or proceeding? Settled

b. On what date was this status reached? July 4, 1988

c. What was the result? (Include felony/misdemeanor, a description of the penalties, amount of fine, payment or settlement; terms of the disposition, length of suspension or restriction, etc.) The firm decided to settle the claim for \$5,000. I contributed all of the settlement amount.

9. You may provide a brief summary of this event or proceeding. (Your information must fit within the space provided.)  
 \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

MONTH DAY YEAR

SIGNATURE OF APPLICANT

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## REQUEST FOR COMMENTS

**Subject: Proposed Amendment to Schedule E Re: Exemption From the Pricing Requirements For Shelf Offerings to Institutional Investors**

### EXECUTIVE SUMMARY

The NASD is publishing for comment an amendment to Schedule E to the NASD By-Laws that would exempt a qualified independent underwriter from the pricing requirements of Section 3(c)(1) of Schedule E in connection with "shelf offerings" distributed pursuant to SEC Rule 415 that are to be distributed solely to "institutional investors." The qualified independent underwriter would be required to participate in the preparation of the registration statement and prospectus and to conduct due diligence throughout the effectiveness of the registration statement.

The text of the amendment follows this notice.

### BACKGROUND

For the past two years, a Subcommittee of the Corporate Financing Committee has studied the corporate financing activities in which members engage for the benefit of their issuer-clients in connection with takeover transactions, corporate reor-

ganizations, and merchant-banking activities. The subcommittee also studied how members use SEC Rule 415 (17CFR 230.415, referred to as "Rule 415"), which governs the offering of securities on a delayed or continuous basis ("shelf offerings") to refinance those takeover transactions.

The Subcommittee has reported on these activities to the full Committee and has made recommendations on how Schedule E to the NASD By-Laws ("Schedule E") and the Interpretation of the Board of Governors — Review of Corporate Financing (the "Interpretation") should be amended to regulate the distribution-related issues that were identified. The Subcommittee reviewed numerous transactions in which members acted as financial advisors, consultants, and underwriters in connection with private placements of high-yield debt securities to institutional customers. The placement of the high-yield debt securities in a private offering permits a rapid acquisition or restructuring of the target company. In addition, member firms often were permitted to participate as a "partner" in the takeover transaction by purchasing equity securities of the company on the same terms as were other insiders. In these latter cases, the member departs from the traditional role

of financial consultant or advisor and becomes a principal in the takeover transaction.

In such transactions, the member also agrees to provide liquidity to its institutional customers, and the issuer usually grants demand registration rights to the institutional investors. The registration rights generally obligate the issuer to file a registration statement covering the securities and use its best efforts to have the registration statement declared effective within six months of the closing of the private offering. As a result, the securities become freely transferable, and the institutional investor can act as a selling security holder in a public distribution of the securities and sell or otherwise transfer the securities on a delayed or continuous basis under Rule 415.

#### SUMMARY OF PROPOSED AMENDMENTS

As noted above, in many of these situations the member purchases an equity interest in the issuer. In cases where the ownership interest of the member rises to the level of affiliation as defined in Schedule E, and the member represents that it intends to provide liquidity to its institutional customers or to execute sale transactions in the "shelf" securities on their behalf, Schedule E would apply to the offering.

Schedule E contains requirements intended to deal with the conflicts of interest present when a member underwrites its own securities or the securities of an affiliate. These conflicts generally arise when the member engages in pricing the offering and conducting due diligence. Schedule E, therefore, requires the participation of a "qualified independent underwriter" in the offering. The qualified independent underwriter is required to perform independent due diligence, participate in the preparation of the registration statement and prospectus and to provide a recommendation stating that, in its opinion, the securities being distributed to the public are offered at a yield that is no lower or a price that is no higher than that which it would recommend.

The Committee recognizes, however, that transactions in "high-yield" debt securities generally take place in negotiated transactions between institutional investors and are usually in large amounts. In light of this fact, the Committee believes that it is neither practical nor necessary to require a pricing opinion from a qualified independent underwriter every time a selling security

holder wishes to sell a portion of its securities off the shelf. The Committee recognizes that many institutional investors regularly invest large amounts of money in high-yield securities and that they are capable of determining a fair yield or dividend for such securities. As a result, the Committee believes that it is appropriate to exempt a qualified independent underwriter from rendering an opinion on the price of the securities to be offered as required under Section 3(c)(1) of Schedule E if the securities are sold solely to institutional investors.

Under the proposal, Section 2 of Schedule E would be amended to define an institutional investor as:

a bank, savings and loan association, insurance company, registered investment company, or investment advisor that has more than \$100 million under management, or an entity (whether a natural person, corporation, partnership, trust or otherwise) with gross assets of at least \$100 million that can demonstrate that it regularly invests in the type and dollar amount of the securities being offered.

Additionally, proposed subsection 3(d) of Schedule E provides conditions under which the pricing recommendation of a qualified independent underwriter would not be required. They are: (1) the securities offered are registered with the SEC pursuant to the Securities Act of 1933; (2) the securities are to be offered or sold pursuant to Rule 415 adopted under the Securities Act of 1933; (3) the securities will be offered or sold from time to time in negotiated transactions; (4) sales by the affiliated member must be made solely to institutional investors defined in Subsection 2(n); and (5) the qualified independent underwriter complies with its due diligence responsibility on a continuous basis as long as the registration statement is effective.

With respect to the qualified independent underwriter's due diligence responsibilities, the Committee is aware that members acting as qualified independent underwriters employ different procedures in order to comply with their obligation to "... exercise the usual standards of 'due diligence' ..." in connection with the distribution of a public offering. The qualified independent underwriters and their counsel must determine which procedures they will use and whether those procedures will permit them to

represent to the NASD that they have exercised the usual standards of due diligence. The NASD believes that, as long as the registration statement is effective, a qualified independent underwriter must, at a minimum, receive the following information: all correspondence with the SEC relating to the offering; all press releases; and all other documents customarily reviewed by underwriters in connection with a due diligence review, including quarterly and annual financial statements and reports. The NASD will require that a qualified independent underwriter be contractually obligated to receive this information on a continuous basis, as long as the registration statement is effective, so that it can comply with its due diligence responsibility.

On June 1, 1988, the NASD adopted an amendment to the Interpretation entitled "Proceeds Directed to a Member." This provision governs members' participation in public offerings where more than 10 percent of the net offering proceeds are intended to be paid to members participating in the distribution of the offering, or associated or affiliated persons of such members, or members of the immediate family of such persons. Such participation requires the pricing opinion and due diligence of a qualified independent underwriter. The exception for Rule 415, Schedule E offerings discussed above also has been proposed to apply to "proceeds offerings" where a qualified independent underwriter is required. That proposed amendment is contained in the proposed Corporate Financing Rule [see Section C(8)(ii)], which was published for comment in NASD Notice to Members 88-92, November 1988. The last date for comment on that proposal is December 31, 1988.

Comments on the proposed amendment to Schedule E should be directed to:

Mr. Lynn Nellius, Secretary  
National Association of Securities Dealers, Inc.  
1735 K Street, NW  
Washington, DC 20006-1506

Comments must be received **no later than December 31, 1988**. Comments received by this date will be reviewed by the NASD Corporate Financing Committee and the NASD Board of Governors. If the proposed amendment, or an amended version resulting from comments received, is approved by the Board, it must be filed with and approved by the Securities and

Exchange Commission before becoming effective.

Questions concerning this notice can be directed to Richard J. Fortwengler, Assistant Director, Corporate Financing, at (202) 728-8254.

## Proposed Amendments to Schedule E to the By-Laws of the NASD

### Section 2

#### Definitions

(h) **Institutional Investor** - an investor which comes within any of the following categories:

(a) a bank, savings and loan association, insurance company or registered investment company;

(b) an investment advisor registered under Section 203 of the Investment Advisors Act of 1940 that has more than \$100 million under management; or

(c) an entity (whether a natural person, corporation, partnership, trust or otherwise) with gross assets of at least \$100 million which can demonstrate that it regularly invests in the type and dollar amount of the securities being offered.

### Section 3

#### Participation in Distribution of Securities of Member or Affiliate

(d) The provision of Subsection 3(c)(1) which requires that the price of the securities be established based on the recommendation of a qualified independent underwriter shall not apply to an offering if:

(1) the securities are registered with the Securities and Exchange Commission pursuant to the Securities Act of 1933, as amended;

(2) the registration statement pertains only to securities which are offered or sold pursuant to Rule 415 adopted under the Securities Act of 1933, as amended;

(3) the securities will only be offered or sold from time to time in negotiated transactions;

(4) sales by the affiliated member will be made solely to institutional investors; and

(5) the qualified independent underwriter complies with Section 2 (1) and fulfills all other requirements of Section 3(c)(1) on a continuous basis throughout the effectiveness of the registration statement.

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## Subject: Trade Date-Settlement Date Schedule: Christmas Day, New Year's Day, and Martin Luther King, Jr. Day

### Christmas Day and New Year's Day

Securities markets and the NASDAQ System will be closed on Monday, December 26, 1988 and Monday, January 2, 1989 in observance of Christmas Day and New Year's Day respectively. "Regular-way" transactions made on the preceding business days will be subject to the settlement date schedule listed below.

### Trade Date-Settlement Date Schedule for "Regular-Way" Transactions

Trade Date	Settlement	Reg. T*
December 16	23	28
19	27	29
20	28	30
21	29	Jan. 3, 1989
22	30	4
23	January 3	5
26	Markets Closed	—
27	4	6
28	5	9
29	6	10
30	9	11
January 2	Markets Closed	—
3	10	12

### Martin Luther King, Jr. Day:

The schedule of trade dates/settlement dates below reflects the observance by the financial community of Martin Luther King, Jr.'s Day, Monday, January 16, 1989. On January 16, the NASDAQ System and the exchange markets will be open for trading. However, it will not be a settlement date since many of the nation's banking institutions will be closed.

### Trade Date-Settlement Date Schedule For "Regular Way" Transactions

Trade Date	Settlement	Reg. T*
January 5	12	16
6	13	17
9	17	18
10	18	19
11	19	20
12	20	24
13	23	24
16	23	25
17	24	26

January 16, 1989, is considered a business day for receiving customers' payments under Regulation T of the Federal Reserve Board.

Securities will not be quoted ex-dividend, and settlements, marks to the market, reclamations, buy-ins and sell-outs, as provided in the Uniform Practice Code, will not be made and/or exercised on January 16.

The foregoing settlement dates should be used by broker-dealers and municipal securities dealers for purposes of clearing and settling transactions pursuant to the NASD Uniform Practice Code and Municipal Securities Rulemaking Board Rule G-12 on Uniform Practice.

Questions regarding this notice should be

directed to the NASD Uniform Practice Department at (212) 858-4341.

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\*Pursuant to Sections 220.8(b)(1) and (4) of Regulation T of the Federal Reserve Board, a broker-dealer must promptly cancel or otherwise liquidate a customer purchase transaction in a cash account if full payment is not received within seven (7) business days of the date of purchase or, pursuant to Section 220.8(d)(1), make application to extend the time period specified. The date by which members must take such action is shown in the column entitled "Regulation T Date."



# Notice To Members

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## Subject: Mergers by Members With Blind-Pool Companies

### EXECUTIVE SUMMARY

NASD members are advised that their participation in certain transactions with blind-pool companies may be inconsistent with the provisions of Schedule E to the NASD By-Laws. The merger or acquisition of an NASD member firm or its parent by or with a blind-pool company that results in the direct or indirect public ownership of an NASD member or its parent must comply with the provisions of Schedule E. A "blind-pool" company is formed by a public offering of equity securities of a corporate

entity in which the issuer discloses that the net proceeds of the offering will be used to search for and acquire as yet unidentified existing businesses. Because of the importance that the NASD places on the investor protection provisions of Schedule E, the NASD is publishing its views on the application of Schedule E to the By-Laws, the disclosure provisions of the Securities Act of 1933, and the anti-fraud provisions of Securities Exchange Act of 1934 to such transactions.

### BACKGROUND

Recently, the NASD Corporate Financing Department has reviewed a number of public offerings of equity securities of recently formed corporations that raised between \$400,000 and \$800,000 from the public. In such offerings, the public offering document does not disclose a business plan for investment of the capital raised by the corporation. Rather, the offering document discloses that the corporation has been formed for the purpose of seeking business opportunities believed to hold a potential for profit. Such business opportunities include merging with or into existing busi-

nesses or acquiring assets to establish subsidiary businesses. The companies' officers and directors have complete discretion in the use of the proceeds they receive from the public. Such offerings are generally referred to as "blind-pool" or "blank-check" corporate offerings.

In a number of instances, the NASD has learned that certain shell companies that became public through blind-pool public offerings have merged with or been acquired by an NASD member or the member's parent. These transactions are usually effected through the issuance of additional shares of stock of the blind-pool company to the

owners of the private member firm or its parent.

For example, one blind-pool company was formed in November, 1985 and began its initial public offering in late 1986. It concluded the public offering on February 17, 1987, with net proceeds of \$130,000, and acquired an inactive broker/dealer March 2, 1987. It acquired the broker/dealer by issuing 10.8 million shares of common stock that had a stated value of \$54,000. In this acquisition, the board of directors of the blind-pool company did not engage an independent accountant or investment banker to verify the stated value that it had set for the common stock.

In another instance, a blind-pool company effected a reorganization with a member. Approval of the reorganization was accomplished by the issuance and solicitation of proxies to the holders of the common stock of the blind-pool company. The terms of the reorganization called for the issuance of 20 million shares of common stock of the blind-pool company to the three shareholders of the member, and for three persons associated with the member to be elected directors of the blind-pool company after the close of the reorganization. Additionally, the terms of the reorganization provided for the officers of the blind-pool company to be replaced by the officers of the member. In this transaction, no independent appraisals were used to determine the exchange ratio of the stock.

#### EXPLANATION OF SCHEDULE E TO THE BY-LAWS OF THE ASSOCIATION

In the merger and corporate reorganization described above, two member firms became publicly owned without compliance with Schedule E to the NASD By-Laws. The NASD adopted Schedule E in 1972 to address the NASD's special concerns in ensuring that public investors are protected adequately when investing in a member or its parent that is going public. Schedule E contains provisions that are designed to ensure investors that the price of the equity securities that are offered is no higher than the price recommended by a qualified independent underwriter (i.e. a member with a background in underwriting and a history of profitable operations) who has also conducted due diligence and participated in the preparation of the prospectus, offering memorandum, or similar document. These provisions provide investors protection from the conflicts of interest that exist when a member or a parent of a member offers its own

securities to the public. The NASD has always believed that any offering of securities resulting in the direct or indirect public ownership of a member is subject to Schedule E and should be filed with the Corporate Financing Department for review, regardless of whether such offering is made pursuant to a registration statement or offering circular. The NASD clarified this view when it published proposed amendments to Schedule E in Notice to Members 80-39, dated August 11, 1980<sup>1</sup> and in SEC rule filing SR-NASD 80-29<sup>2</sup>.

#### ISSUES RAISED BY A MERGER WITH A BLIND-POOL COMPANY

Section 9 of Schedule E is designed to ensure that an offering by an issuer that is not an affiliate of a member at the time of the offering, but as a result of the offering will be a member's affiliate, is conducted in compliance with Schedule E. Section 9 sets forth a number of types of transactions resulting in public ownership of a member and clarifies that Schedule E is applicable in such specified instances. Section 9 goes on, however, to make clear that:

"If an issuer proposes to engage in any offering which . . . results in the public ownership of a member . . . the offering shall be subject to the provisions of Schedule E . . ." (emphasis provided).

Thus, if a publicly owned issuer merges with a member, or a publicly owned issuer is acquired by a member or a parent of a member, the merger transaction would be subject to Schedule E since it would constitute an offering that results in the

<sup>1</sup>NASD Notice to Members 80-39, published August 11, 1980, at page 13 proposed that then Section 2(o) be revised to ". . . make it clear that public offerings whose proceeds are received by a member and public exchange offers for interests in members are subject to Schedule E. It would also be clarified that any other offering that results in the public ownership of a member would be subject to Schedule E . . ."

<sup>2</sup>SR-NASD-80-29, filed with the SEC December 31, 1980, at page 52 proposed that Section 9 (then Section 8) be revised to ". . . clarify that any other type of offering which results in the public ownership of a member would also be subject to Schedule E . . ." The rule filing goes on to state that "Section [9] of the proposed rule change broadens the scope of former Section 2(o) with the purpose of inhibiting circumvention of Schedule E."

direct or indirect public ownership of the member. Members are cautioned that mergers or acquisitions involving an issuer and a member or its parent that result in the public ownership of the member or its parent are subject to Schedule E regardless of whether the merger or acquisition occurs subsequent to the public offering.

Schedule E also applies to corporate reorganizations similar to the example cited in which a blind-pool company issues a proxy statement to investors. The proxy statement solicits their consent to a reorganization that results in the acquisition of a member or its parent, and previously authorized, but unissued, shares are to be issued to the owners of the member or its parent as a result of the affirmative action of the shareholders of the blind-pool company. Section 9 of Schedule E requires that the reorganization that is the subject of the proxy be carried out in compliance with Schedule E.

Therefore, members are cautioned that pursuant to Section 14 of Schedule E, proxy materials filed with the SEC under SEC rules that involve a reorganization to acquire a member or its parent must be filed with the NASD Corporate Financing Department for review and must be in compliance with the provisions of Schedule E prior to the

effective date of the reorganization. In addition, if a business combination between a member or its parent and a blind-pool company should be proposed and the result of the transaction would be that the member or its parent would be publicly held, the documents relating to that transaction must be filed with the NASD for review under Schedule E.

The NASD also believes that where there is a short time period between the close of a public offering and the close of a merger, (in the case noted above, nine business days) serious questions arise concerning whether the member and the issuer provided adequate disclosure to the public with respect to merger negotiations that may have been in progress prior to the closing of the offering. If such merger negotiations were in progress and the prospectus was not amended to disclose them, serious violations of the Securities Act of 1933 and the anti-fraud provisions of the Securities Exchange Act of 1934 may have occurred.

Questions regarding this notice can be directed to Charles L. Bennett, Assistant Director, NASD Corporate Financing Department, at (202) 728-8258.

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| <input checked="" type="checkbox"/> Corporate Finance | <input checked="" type="checkbox"/> Legal & Compliance | <input type="checkbox"/> Options      | <input type="checkbox"/> Systems              |
| <input type="checkbox"/> Government Securities        | <input type="checkbox"/> Municipal                     | <input type="checkbox"/> Registration | <input checked="" type="checkbox"/> Trading   |
| <input type="checkbox"/> Institutional                | <input type="checkbox"/> Mutual Fund                   | <input type="checkbox"/> Research     | <input type="checkbox"/> Training             |

\*These are suggested departments only. Others may be appropriate for your firm.

## Subject: Clarification of NASD Filing Requirements and Review Procedures for Offerings Made Pursuant to SEC Rule 415

**EXECUTIVE SUMMARY**

The NASD is publishing the views of the Corporate Financing Committee on questions that members frequently ask when they are involved in offerings of securities to be conducted pursuant to SEC Rule 415. This Notice states the Committee's view that any transaction engaged in for the benefit of an issuer or its selling security holders that involves distributing securities "off the shelf" on a delayed or continuous basis constitutes par-

ticipation in a public offering on behalf of the member. It also clarifies the filing obligations that members must comply with when they are involved in such offerings. In addition, this Notice presents the Committee's views as to participating in the preparation of the registration statement and exercising the usual standards of due diligence in respect thereto, when a qualified independent underwriter is involved in a Rule 415 offering.

**BACKGROUND**

On November 23, 1983, the Securities and Exchange Commission adopted SEC Rule 415 (17CFR 230.415 referred to as "Rule 415"). Rule 415 governs the offering of securities on a delayed or continuous basis. For the two years prior to its adoption, the NASD commented on a number of issues that it felt would impact the manner in which its members would participate in Rule 415 distributions. One of the NASD's principal concerns was that the compressed time schedules under which members must operate when they participate in Rule 415 offerings would impact the quality of dis-

closure in the prospectus and the ability of underwriters to perform adequate due diligence on the facts presented in the registration statement.

Since 1983, the Corporate Financing Department has received numerous inquiries regarding the review procedures it uses with respect to offerings conducted pursuant to Rule 415 and has been asked to render opinions on how certain provisions of Schedule E to the NASD By-Laws ("Schedule E") and the Interpretation of the Board of Governors — Review of Corporate Financing (the "Interpretation") should be applied to Rule 415 offerings.

The most frequent inquiries relate to: the definition of "participation in a public offering"; the procedures to be followed in connection with NASD filing requirements contained in the Interpretation and Schedule E; and the appropriate timing of a qualified independent underwriter's participation in the preparation of the offering documents.

**Participation in a Public Offering and Filing Requirements**

Frequently, members raise questions about when a member's activities in connection with a distribution subject to Rule 415 are considered to be "participation in a public offering" under NASD rules. Both the Interpretation and Schedule E provide that if a member is to participate in a distribution, it must file the appropriate documents with the Corporate Financing Department and seek an opinion from the Department that it has no objections to the underwriting terms and arrangements that are proposed.

This question first was raised in 1982 shortly after the Securities and Exchange Commission adopted Rule 415 on a temporary basis. The Department presented the issue to the Corporate Financing Committee for its consideration in September 1982. The Committee made a determination that the Department should review all offerings to be distributed under 415 on the basis of all information available at the time of filing with the exception of Rule 415 offerings on Form S-3 that are specifically exempt from filing under the Interpretation.\*

In connection with Rule 415 offerings, the Committee determined to exempt from the filing requirements securities registered on Form S-3 because an issuer able to satisfy Form S-3's "registrant requirements" would be followed closely by investors and market professionals. The Committee also felt that the securities markets would efficiently determine a fair price for the securities being offered and that any underwriting compensation received by members ordinarily would be determined under very competitive circumstances (generally limited to normal brokerage transactions). The Committee did not believe that the same facts were present in Rule 415 offerings where the securities are registered on any form other than S-3.

Additionally, members should note that the Rule 415 S-3 exemption and the investment-grade

rating filing exemption contained in the Interpretation do not apply to offerings otherwise required to be filed because they are subject to Schedule E.

Thus, it is the view of the Committee that the participation of a member in any offering of securities distributed pursuant to Rule 415 constitutes participation in a public offering. The Committee also concluded that any member who is named as a potential distribution participant in the registration statement or who may participate in any transaction that takes securities off the shelf is responsible for ensuring that a timely filing is made with the Department of the documents required to be filed by the Interpretation and/or Schedule E.

**Participation in the Preparation of a Registration Statement and the Conduct of Due Diligence**

Section 3(c)(1) of Schedule E and the provisions of the Interpretation concerning "Proceeds Directed to a Member" require that a qualified independent underwriter conduct due diligence, participate in the preparation of the registration statement and prospectus, and render a pricing opinion on the securities to be offered to the public. From time to time, the question arises as to what actions a member must take to satisfy the requirements that it participate in the preparation of a registration statement and exercise usual standards when conducting due diligence in respect to it. First, the Committee does not believe it appropriate to express an opinion on what constitutes "usual standards of due diligence." The NASD is aware that members, when acting as qualified independent underwriters, employ different due diligence procedures in connection with the distribution of public offerings. The Committee believes that members and their counsel must determine which procedures they will use and whether those procedures will permit them to represent to the NASD that they have exercised the usual standards of due diligence.

The NASD is aware that a qualified independent underwriter may be engaged to participate

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\* Also exempt from filing are securities offered by a corporate, foreign government or foreign government agency that has non-convertible debt with a term of issue of at least four years, or non-convertible preferred securities, rated by a nationally recognized statistical rating organization in one of its four highest generic rating categories.

in the preparation of a registration statement at two distinct points in the registration process. One is when a determination has been made that Schedule E applies to the offering and the services of a qualified independent underwriter are retained prior to the filing of the registration statement. Second, when it is determined during the regulatory review process that Schedule E applies and the services of a qualified independent underwriter must be retained.

In the first instance, when the qualified independent underwriter is retained by the issuer prior to the initial filing of the registration statement, the NASD believes that a member acting as the qualified independent underwriter easily can conduct due diligence and participate in the preparation of the registration statement. The Department assumes that when the qualified independent underwriter submits its opinion letter, undertaking that it has participated in the preparation of the registration statement and has exercised the "usual" standards of due diligence with respect to the offering document, it has had full opportunity to obtain independent verification of the disclosures made in the registration statement.

In the second instance, the Department has reviewed the registration statement filed with it and has made the determination that, based on the facts presented, Schedule E applies to the offering and a qualified independent underwriter must be retained. In those circumstances, the qualified independent underwriter is retained after the registration statement has been drafted and filed with the appropriate reviewing bodies. While the qualified independent underwriter cannot participate in the "preparation" of the registration statement as originally filed, it can conduct due diligence with respect to the registration statement and prospectus document and require the issuer to amend the disclosures made therein if necessary. Thus, the member remains obligated to independently verify the disclosure in the offering document. The Committee recognizes that although the qualified inde-

pendent underwriter has not been involved in the preparation of the registration from the beginning, it has had an opportunity to verify the facts disclosed in the registration statement and to require amendments to be filed if deemed necessary, and it does assume the legal responsibilities and liabilities of an underwriter under the Securities Act of 1933. As a result, the Committee feels that the member has participated in the preparation of the final registration statement that is declared effective.

Circumstances do arise however when the registration statement has not been declared effective and the qualified independent underwriter has not had an adequate opportunity to complete its due diligence investigation, and the issuer and the affiliated member request that the qualified independent underwriter be permitted to comply with its obligations after the effective date of the registration statement. In these circumstances, the NASD believes that the qualified independent underwriter must complete its due diligence investigation and provide the Department with necessary undertakings that it has participated in the preparation of the registration statement and is assuming the responsibilities and liabilities of an underwriter prior to the effectiveness of the registration statement. The NASD has determined that it is inappropriate for a member to act as a qualified independent underwriter if it has not been given the opportunity to complete its due diligence and to participate in the preparation of the registration statement prior to the effective date of the offering. In such cases, the NASD believes that it is not realistic, nor is it appropriate, for a qualified independent underwriter to attempt to fulfill its obligations under Schedule E.

Questions regarding this notice can be directed to Charles L. Bennett, Assistant Director, NASD Corporate Financing Department, at (202) 728-8258 or Richard J. Fortwengler, Assistant Director, NASD Corporate Financing Department at (202) 728-8254.

# Notice To Members

National Association of Securities Dealers, Inc.

December 1988

## Number 88 - 102

### Suggested Routing:\*

- |  |  |  |  |
|--|--|--|--|
| <input type="checkbox"/> Senior Management     | <input checked="" type="checkbox"/> Internal Audit | <input checked="" type="checkbox"/> Operations | <input type="checkbox"/> Syndicate           |
| <input type="checkbox"/> Corporate Finance     | <input type="checkbox"/> Legal & Compliance        | <input type="checkbox"/> Options               | <input checked="" type="checkbox"/> Systems  |
| <input type="checkbox"/> Government Securities | <input type="checkbox"/> Municipal                 | <input type="checkbox"/> Registration          | <input checked="" type="checkbox"/> Trading  |
| <input type="checkbox"/> Institutional         | <input type="checkbox"/> Mutual Fund               | <input type="checkbox"/> Research              | <input checked="" type="checkbox"/> Training |

\*These are suggested departments only. Others may be appropriate for your firm.

### Subject: NASDAQ National Market System Additions as of November 21, 1988

As of November 21, 1988, the following 25 issues joined the NASDAQ National Market System, bringing the total number of issues in NASDAQ/NMS to 2,902:

Symbol	Company	Entry Date	SOES Execution Level
METC	Metcalf & Eddy Companies, Inc.	10/18/88	500
RODS	American Steel & Wire Corporation	10/19/88	500
SOFS	Softsel Computer Products, Inc.	10/20/88	1000
VSBC	VSBC Bancorp, Inc.	10/27/88	500
BHAGB	BHA Group, Inc. (Cl B)	10/31/88	500
GNEXP	Genex Corporation (Pfd)	11/1/88	200
MDEV	Medical Devices, Inc.	11/1/88	500
MWGP	Midwest Grain Products, Inc.	11/1/88	1000
PAGH	Pacific Agricultural Holdings, Inc.	11/1/88	1000
PENG	Prima Energy Corporation	11/1/88	500
SATI	Satellite Information Systems Company	11/1/88	1000
TJCK	Timberjack Corporation	11/1/88	1000
VSLF	VMS Strategic Land Fund II	11/1/88	500
LOGC	Logic Devices Incorporated	11/2/88	200
MTBS	Metro Bancshares, Inc.	11/4/88	1000
GGNS	Genus, Inc.	11/10/88	500
PSAB	Prime Bancorp, Inc.	11/14/88	1000
AGPH	Agouron Pharmaceuticals, Inc.	11/15/88	500
CPRC	Computer Components Corporation	11/15/88	1000
CPRCW	Computer Components Corporation (Wts)	11/15/88	1000
IMRI	IMCO Recycling Inc.	11/15/88	500
QLTIF	Quadra Logic Technologies, Inc.	11/15/88	200

TOMKY	Tomkins, Plc.	11/15/88	200
WAIN	Wainwright Bank & Trust Company	11/15/88	1000
FLSPV	FLS Holdings, Inc. (Ser A Pfd) (WI)	11/18/88	200

### NASDAQ/NMS Pending Additions

The following issues have filed for inclusion in NASDAQ/NMS upon effectiveness of their registration statements with the SEC or other appropriate regulatory authority. Their inclusion may commence prior to the next regularly scheduled phase-in date.

Symbol	Company	Location	SOES Execution Level
BTUI	BTU International, Inc.	North Billerica, MA	1000
FSII	FSI International, Inc.	Chaska, MN	1000
FRCC	First Financial Caribbean Corporation	Puerto Nuevo, PR	1000
GNWF	GNW Financial Corporation	Bremerton, WA	1000
HICA	Hitok Corporation of America	Corpus Christi, TX	500
PMCM	Pico Macom, Inc.	Lakeview Terrace, CA	500
WLPI	Wellington Leisure Products, Inc.	Madison, GA	500

### NASDAQ/NMS Symbol and/or Name Changes

The following changes to the list of NASDAQ/NMS securities occurred since October 18, 1988.

New/Old Symbol	New/Old Security	Date of Change
IEHC/IEHC	IEH Corp./Industrial Electronic Hardware Corp.	10/20/88
CMBK/CMBK	Cumberland Federal Bancorporation, Inc. (The)/ Cumberland Federal Savings Bank (The)	10/25/88
FAHS/FAHS	Farm and Home Financial Corporation/Farm and Home Savings Association	10/25/88
CCUR/CCURD	Concurrent Computer Corp./Concurrent Computer Corp. (New)	10/31/88
COMR/COMR	Comair Holdings, Inc./Comair, Inc.	11/1/88
MCRN/DRAM	Micron Technology, Inc./Micron Technology, Inc.	11/1/88
UBNK/CFBK	Union Bank/California First Bank	11/1/88
COBK/COBK	Co-Operative Bank of Concord (The)/ Co-Operative Bancorp	11/2/88
MTIK/MTIK	Miller Building Systems, Inc./Modular Technology, Inc.	11/2/88
INVF/ISLA	Investors Financial Corporation/Investors Savings Bank	11/3/88
SCSL/SCSLA	Suncoast Savings and Loan Association/Suncoast Savings and Loan Association (CI A)	11/3/88
AFED/AFED	AtlanFed Bancorp, Inc./Atlanta Federal Savings Bank	11/8/88
CHFD/CHFD	Charter Federal Savings Bank/Charter Federal Savings and Loan Association	11/9/88
RHCI/HSAI	Ramsay Healthcare, Inc./Healthcare Services of America, Inc.	11/11/88
TPIE/TELE	TPI Enterprises, Inc./TPI Enterprises, Inc.	11/18/88
MRNO/MOAI	Morino, Inc./Morino Associates, Inc.	11/21/88



## NASDAQ/NMS Deletions

Symbol	Security	Date
ALEC	Alleco, Inc.	10/19/88
DLWD	Delta Woodside Industries, Inc.	10/19/88
UBCP	Unibancorp, Inc.	10/19/88
NCTY	National City Corporation	10/25/88
RKWD	Rockwood Holding Company	10/25/88
SETD	Sierra Capital Realty Trust IV	10/26/88
BEZRY	Beazer, Plc.	10/28/88
MONY	Metropolitan Consolidated Industries, Inc.	10/28/88
VIKG	Viking Freight, Inc.	10/31/88
EWSB	East Weymouth Savings Bank	11/1/88
GNIC	Guaranty National Corp.	11/1/88
ITAN	InterTAN, Inc.	11/1/88
KISC	Kimmons Corp.	11/1/88
MLMC	Multi-Local Media Corp.	11/1/88
RESM	Restaurant Management Services, Inc.	11/1/88
RICH	Richmond Hill Savings Bank	11/1/88
MOKG	Morgan, Olmstead, Kennedy and Gardner Capital Corp.	11/4/88
LOND	London House, Inc.	11/7/88
GPAK	Graphic Packaging Corp.	11/8/88
BOLT	Bolt Technology Corporation	11/9/88
CRMK	Cermetek Microelectronics, Inc.	11/9/88
CITQE	CitiPostal, Inc.	11/9/88
CSCN	Compuscan, Inc.	11/9/88
ELEX	Elaxis Corporation	11/9/88
HHBX	HHB Systems, Inc.	11/9/88
IBSI	Independent Bankshares, Inc.	11/9/88
MXXX	Mars Stores, Inc.	11/9/88
MMSTE	MedMaster Systems, Inc.	11/9/88
TRVMF	T.R.V. Minerals Corporation	11/9/88
TSIC	Transducer Systems, Inc.	11/9/88
TUHC	Tucker Holding Company, Inc.	11/9/88
XEBC	Xebec	11/9/88
GROF	Groff Industries, Inc.	11/10/88
HYPX	Hyponex Corporation	11/10/88
MNST	Minstar, Inc.	11/11/88
CFMIE	Convenient Food Mart, Inc.	11/16/88
RDKN	Redken Laboratories, Inc.	11/16/88

Questions regarding this notice should be directed to Kit Milholland, Senior Analyst, NASDAQ Operations, at (202) 728-8281. Questions pertaining to trade reporting rules should be directed to Leon Bastien, Assistant Director, NASD Market Surveillance, at (202) 728-8192.

# For Your Information

National Association of Securities Dealers, Inc.

December 1988

## Test Center Changes in January: Puerto Rico and Nebraska

Please note the following test center changes in *January*: The first Saturday test session in Puerto Rico will be held on Saturday, January 14, 1989.

The January 21, 1989, Series 7 session in Lincoln, Nebraska, has been changed from the

usual campus location to the following new location:

East Union Building  
East Campus,  
Lincoln, Nebraska

Candidates can call (402) 472-2844 for directions.

### Important Note: Correction to Notice To Members 88-81

Number 88-81 has been inadvertently assigned to two notices, one in the October issue and one in the November issue. To avoid con-

fusion, the notice in the November issue dealing with broker-dealer and agent renewals will be listed in the indexes as 88-81a.

# Notice To Members

National Association of Securities Dealers, Inc.

December 19, 1988 — Supplement

## Number 88 - 103

### Suggested Routing:\*

- |   |  |  |   |
|---|--|--|---|
| <input checked="" type="checkbox"/> Senior Management | <input type="checkbox"/> Internal Audit                | <input checked="" type="checkbox"/> Operations | <input type="checkbox"/> Syndicate          |
| <input type="checkbox"/> Corporate Finance            | <input checked="" type="checkbox"/> Legal & Compliance | <input type="checkbox"/> Options               | <input type="checkbox"/> Systems            |
| <input type="checkbox"/> Government Securities        | <input type="checkbox"/> Municipal                     | <input type="checkbox"/> Registration          | <input checked="" type="checkbox"/> Trading |
| <input checked="" type="checkbox"/> Institutional     | <input type="checkbox"/> Mutual Fund                   | <input type="checkbox"/> Research              | <input type="checkbox"/> Training           |

\*These are suggested departments only. Others may be appropriate for your firm.

## Subject: Adoption of Rule Amendments — Effective Immediately — to Prohibit Professional Trading in SOES

### EXECUTIVE SUMMARY

The Securities and Exchange Commission (SEC) recently approved amendments to the Rules of Practice and Procedures for the Small Order Execution System (SOES or SOES Rules) proposed by the NASD to prohibit members from entering orders in SOES on behalf of a professional trading account. The rule amendments are designed to eliminate the abuse of SOES by Order Entry Firms that use the system to execute transactions for professional trading accounts.

The amendments are effective immediately.

### BACKGROUND AND ANALYSIS

In 1984, SOES was created by the NASD to provide an efficient and economical facility for the execution of small, retail orders in NASDAQ securities by public customers. The system was intended to further the investment objectives of retail customers, who typically have longer-term trading goals than those of professional traders. Thus, SOES is available only for retail customer orders of specified, small size, and the SOES Rules prohibit members from breaking up larger

orders for execution in SOES. In recent months, the NASD has become aware of instances in which some firms have been engaging in practices that could impact the viability of SOES. These practices include placing orders of professional traders or "day trades" through SOES. Most of these orders follow patterns of professional trades in that offsetting purchases and sales are made during the trading day.

The NASD is concerned that the execution in SOES of transactions of professional traders may distort the price at which retail investors are able to obtain execution of their transactions. To remedy the problem, earlier this year the NASD implemented SOES rule interpretations that prohibit certain securities industry professionals from entering orders into SOES for their personal accounts or for accounts of members of their immediate families. Other SOES rule interpretations permit the NASD to aggregate SOES trades entered within any five-minute period for accounts controlled by an associated person or a customer for determining compliance with SOES order-size limits.<sup>1</sup>

### EXPLANATION OF AMENDMENTS

On December 15, 1988, the SEC approved the following amendments to SOES Rules to

eliminate the entering and execution of certain orders in SOES by SOES Order Entry Firms. The new rule changes do the following:

- Prohibit a member or person associated with a member from entering orders in SOES on behalf of a professional trading account.
- Provide that compliance with this requirement is presumed if (1) the member instructs its associated persons that they shall not knowingly accept an order for SOES from a professional trading account and (2) the member has not been advised by the NASD that the account has been classified as a professional trading account.
- Require members, upon written request from the NASD, to report information to the NASD concerning orders entered into SOES.
- Specify that the NASD may identify accounts as professional trading accounts.
- Define the term "professional trading account" to mean:

- (i) an account in which five or more day trades have been executed through SOES during any trading day; or
- (ii) an account in which there has been a professional trading pattern in SOES as demonstrated by a pattern or practice of executing day trades, executing a high volume of day trades in relation to the total transactions in the account, or executing a high volume of day trades in relation to the amount and value of securities held in the account.

■ Define the term "day trade" to mean the execution of offsetting trades in the same security for generally the same size during the same trading day.

The NASD believes that the amendments to the SOES Rules will eliminate the abusive practice of SOES members or persons associated with members using SOES for the execution of transactions for professional trading accounts. Such a practice is inconsistent with the original purpose of SOES, to facilitate the execution of small retail orders by public customers.

The NASD's automated surveillance systems are geared to monitor member compliance with these new requirements on an on-line basis.

**The rule amendments shall be effective immediately.**

Any questions regarding the notice may be directed to Dennis C. Hensley, Vice President and Deputy General Counsel, NASD, at (202) 728-8245, or Encida Rosa, Assistant General Counsel,

NASD, at (202) 728-8284.

## RULES OF PRACTICE AND PROCEDURES FOR THE SMALL ORDER EXECUTION SYSTEM

(Note: New language is underlined.)

### a) DEFINITIONS

10. The term "professional trading account" shall mean

(i) an account in which five or more day trades have been executed through SOES during any trading day; or

(ii) an account in which there has been a professional trading pattern in SOES as demonstrated by a pattern or practice of executing day trades, executing a high volume of day trades in relation to the total transactions in the account, or executing a high volume of day trades in relation to the amount and value of securities held in the account.

11. The term "day trade" or "day trading" shall mean the execution of offsetting trades in the same security for generally the same size during the same trading day.

### c) PARTICIPATION OBLIGATIONS IN SOES

#### 3. SOES Order Entry Firms

(E)(i) No member or person associated with a member shall enter any order for execution in SOES on behalf of a professional trading account.

(ii) A member will be presumed to be in compliance with Subsection (i) if (a) the member instructs persons associated with the member that no such person shall knowingly accept any order for entry into SOES from a professional trading account, and (b) the Association has not notified the member that the account has been classified as a professional trading account pursuant to subsection (iii) hereof.

(iii) Upon receiving written notice from the Association, a member shall report to the Association information concerning transactions entered into SOES by the firm and such other information as the Association may request. Based upon such information, the Association may identify to the member specific accounts as professional trading accounts.

<sup>1</sup> See NASD *Notices to Members* 88-61, August 25, 1988, Supplement.

# Notice To Members

National Association of Securities Dealers, Inc.

December 30, 1988 — Supplement

## Number 88 - 104

### Suggested Routing:\*

- |   |  |  |   |
|---|--|--|---|
| <input checked="" type="checkbox"/> Senior Management | <input checked="" type="checkbox"/> Internal Audit     | <input checked="" type="checkbox"/> Operations | <input checked="" type="checkbox"/> Syndicate |
| <input type="checkbox"/> Corporate Finance            | <input checked="" type="checkbox"/> Legal & Compliance | <input type="checkbox"/> Options               | <input checked="" type="checkbox"/> Systems   |
| <input type="checkbox"/> Government Securities        | <input type="checkbox"/> Municipal                     | <input type="checkbox"/> Registration          | <input checked="" type="checkbox"/> Trading   |
| <input type="checkbox"/> Institutional                | <input type="checkbox"/> Mutual Fund                   | <input type="checkbox"/> Research              | <input type="checkbox"/> Training             |

\*These are suggested departments only. Others may be appropriate for your firm.

### Subject: Adoption of Rule Amendments Mandating the Automated Submission of Trading Data — Effective February 12, 1989

#### EXECUTIVE SUMMARY

The Board of Governors of the National Association of Securities Dealers, Inc. (NASD) recently approved an amendment to Part VI, Section 4 of Schedule D and Section 3 of Schedule H of the NASD's By-Laws mandating that standardized requests for trading data, (i.e., trading questionnaires or "blue sheet" information) be submitted in an automated format. The rule amendments will be filed with the Securities and Exchange Commission (SEC) and, subject to the SEC's approval, will be effective February 12, 1989.

#### BACKGROUND

The NASD and the other self-regulatory organizations comprising the Intermarket Surveillance Group (ISG)<sup>1</sup> have adopted uniform policies and procedures for ensuring timely response by their members to standardized requests for trading data, which emanate from their market surveillance functions. This is in recognition of the need to reduce the time it takes to conduct an investigation and to assist members in expediting responses to the numerous requests for information received from the regulatory agencies.

These incentives are also in response to SEC initiatives calling for more timely referral of regulatory matters to the SEC.

#### EXPLANATION OF AMENDMENTS

The amended rule requires NASD members to respond to standardized market surveillance requests for customer and proprietary trading information in NASDAQ securities by using the NASD's automated electronic "blue sheet" system. This trading information is limited to the type normally requested on a standard trading questionnaire or blue sheet and generally includes price and volume for transactions on behalf of customers or for proprietary accounts. In this regard, all members receiving such a request for information must make arrangements to file their response electronically through the Association's automated blue sheet system starting no later than February 12, 1989. Upon request, the Association may grant an exception from such requirement under certain limited circumstances. It is the NASD's understanding that all ISG participants will require their members to submit trading data in an automated fashion by the February 12, 1989, deadline noted above.

This proposed amendment is very similar in nature to the amendments that have been filed with

the SEC by the other ISG participant self-regulatory organizations. Approval for this amendment is expected shortly. Detailed specifications as to the method of transmitting blue sheet data to the NASD will be the subject of a separate *Notice to Members*, which will be issued in early 1989.

**TIMELINESS GUIDELINES  
FOR RESPONDING TO  
REQUEST FOR INFORMATION**

**The 10-Business-Day Standard**

In a related matter and in conjunction with other ISG initiatives, any NASD requests for trading information dated on or after February 12, 1989, must be answered within no more than 10 business days of the date of the request. This is a new industry standard that will be employed by all self-regulatory organizations. Submissions of requested data that are received after the deadline or that are in a format other than that requested will be subject to probable disciplinary action unless an extension has been granted by the NASD prior to

the requested return date. To assist NASD members in meeting this 10-business-day standard, the Market Surveillance Department will transmit all requests for blue sheet information by FAX if they are provided with a specific number where FAX transmissions can be sent.

Any questions regarding this Notice may be directed to James M. Cangiano, Vice President, Market Surveillance at (202) 728-8186 or to Eneida Rosa, Assistant General Counsel, at (202) 728-8284.

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<sup>1</sup> The members of the ISG are as follows: The American Stock Exchange, the Boston Stock Exchange, the Chicago Board Options Exchange, the Cincinnati Stock Exchange, the Midwest Stock Exchange, the National Association of Securities Dealers, the New York Stock Exchange, the Pacific Stock Exchange, and the Philadelphia Stock Exchange. Representatives from the SEC staff also attend ISG meetings.